United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-4231

In The

United States Court of Appeals

For The Second Circuit

ALAN NEMSER and SELMA W. NEMSER,

Petitioners-Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

B
P/S

BRIEF FOR PETITIONERS-APPELLANTS

ALAN NEMSER
Attorney Pro Se and on behalf of Petitioner-Appellant Selma W. Nemser
32 Court Street
Brooklyn, New York 11201
(212) 624-0508

(10258)
LUTZ APPELLATE PRINTERS, INC.
Law and Financial Printing
South River, N.J. (201) 257-6850
New York, N.Y. (212) 563-2121
Philadelphia, Pa. (215) 563-5587
Washington, D.C. (201) 783-7288

TABLE OF CONTENTS

Table of Cases, Statutes and Other Authorities

Preliminary Statement

This is an appeal from the decision of Judge Featherston, Judge of the United States Tax Court, rendered in favor of the respondent Commissioner of Internal Revenue on July 27, 1976. A copy of the opinion is included in the appendix herein.

Nature of the Case

Taxpayers petitioned the United States Tax Court to review and set aside a deficiency determination of $6,782.32 made by the respondent with respect to petitioners' 1968 Federal income tax return and based upon respondent's disallowance of deductions made pursuant to Section 642 (h) (2) of the Internal Revenue Code. The case was presented to the Tax Court for detemination on the stipulated facts contained in the appendix herein.

Issue Presented for Review

Section 642 (h) (2) of the Internal Revenue Code of 1954 provides in pertinent part as follows:

> "If on the termination of an estate or trust the estate or trust has ---------- (2) for the last taxable year of the estate or trust, deductions (other than the deductions allowed under subsections (b) or (c))in excess of gross income for such year, then such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary or his delegate, to the beneficiaries succeeding to the property of the estate or trust."

Section 1.642 (h) -3 of the Tax Regulations defines the Tax Law Section 642 (h) (2) "beneficiary" as follows:

> "Sec. 1.642 (h) -3 Meaning of 'beneficiaries succeeding to the property of the estate or trust'. (a) The phrase 'beneficiaries succeeding to the property of the estate or trust' means those beneficiaries upon termination of the estate or trust who bear the burden of any loss."

The sole question before this Court is whether, under the stipulated facts, the petitioner herein, who received a distribution of his share of the net assets of a trust in its terminal year is a "beneficiary succeeding to the property of the estate or trust" within the purview and meaning of the Code Section and the Tax Regulation, so as to entitle him to take as a deduction against his personal income, his pro rata share of the unused deductions in the terminal year of the trust.

POINT ONE

PETITIONER IS A "BENEFICIARY SUCCEEDING TO THE PROPERTY OF THE TRUST" WITHIN THE MEANING OF THE TAX LAW, THE TAX REGULATIONS AND THE LEGISLATIVE INTENDMENT OF THE LAWMAKERS

The Court below has concluded that the Taxpayer herein is not a "beneficiary succeeding to the property of the estate or trust" within the meaning of Section 642 (h) (2) of the Internal Revenue Code.

In arriving at that conclusion the Court has reasoned that the use of the word "succeeding" in the phrase "beneficiaries succeeding to the property" indicates that the section was intended to refer only to recipients of property by bequest, devise or inheritance under State succession laws. (Appendix at 17) Assuming that we accept for the moment that the use of the word "succeeding" is an indication of the intention to confer the benefits of the section upon the persons who take under State succession laws, namely, the heirs at law and next of kin, would that not exclude all others not in that category and not named in the section? How then does the Tax Court proceed to include those who take by bequest or devise, since such persons are not necessarily in the chain of intestate succession, and they are not specificially referred to in the Code section, which talks only of "beneficiaries succeeding to the property"?

If we agree that legatees and devisees should not be excluded from the benefits of the section then the only logical interpretation of the section is that it was intended to include all persons entitled to ultimate distribution in the estate or trust whose distribution is reduced by the expenses of the trust in excess of income in its terminal year. The word "succeeding" can only have been intended to define and describe the person who was entitled to and received ultimate distribution, whether he succeeded to the property as a devisee, as a legatee, an heir at law or next of kin, or, as in the case at bar, the <u>successor</u> in interest by virtue of an assignment.

The Taxpayer in the case at bar falls squarely within the language of the Code section and Tax Regulation. The Supreme Court of the State of Illinois has decreed that he is the person who succeeds to the property of the trust. His distributive fractional share, as so decreed, has been diminished by the amount of his pro rata share of trust deductions in excess of gross income for the terminal year of the trust, thereby directly bearing the loss as defined by the Regulation.

Further definition is given by Section 1.642 (h)-4 of the Tax Regulations, which provides that excess deductions are allocated proportionately according to the share of each in the burden of the deductions. Petitioner's pro rata share of excess unused deductions was $14,394.12, the amount taken by petitioner as a deduction in his personal return. (Appendix at 8)

If further proof is needed that the Section was intended to benefit the person to whom the property was ultimately distributed and who suffered the economic loss, one need only refer to the report of the Senate Finance Committee which accompanied the bill that was ultimately enacted, which stated in part, as follows: (underlining supplied)

> "Under this provision [sec. 642 (h)] unused loss carryovers and deductions in excess of gross income in the year of termination of the estate or trust are made available <u>to the remaindermen to whom the property is distributed.</u> Under existing law these unused carryovers and excess deductions are wasted when the estate or trust terminates."

In like fashion, the Report of the House Ways and Means Committee on the same bill stated, in part, as follows:

> "Under Subsection (d) [the House provision was sec. 622 (d), which by Senate amendment was moved to sec. 642 (h)] any *** deductions in excess of gross income *** upon the termination of an estate or trust are made available, in accordance with regulations, to the beneficiaries or remaindermen succeeding to the property. Under existing law, these unused loss carryovers are lost when the estate or trust terminates (Cf. Charles Neave, 17 T.C. 1237). [H. Rept. No. 1337, supra at A201]"

The unmistakable emphasis in both the Senate and House reports is that the benefit should be available to the person "to whom the property is distributed" and to the person "succeeding to the property". Tax Regulation 1.642 (h)-3 (supra) added the requirement that such a person be the person who bore the burden of the loss.

The Tax Court has nevertheless held that the Taxpayer is not entitled to the deductions allowable under the section because he is not the kind of beneficiary intended by the section. The Tax Court has concluded that the section to be construed has the meaning it would have had if it read as follows:

> "******* , then such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary or his delegate to the beneficiaries to whom distribution is made by virtue of a bequest, devise or inheritance under State succession laws."

Can it be that our lawmakers could not find these simple words to give expression to the intention which the Tax Court says they had in mind?

Black's Law Dictionary, 4th edition, 1968, gives the following definitions of "beneficiary" : (underlining supplied)

> "Beneficiary. One for whose benefit a trust is created; a cestui que trust, 195 N.E. 557,564, 97 A.L.R. 1170. A person having the enjoyment of property of which a trustee, executor, etc. has the legal possession. The person to whom a policy of insurance is payable. One receiving benefit or advantage, or one who is in receipt of benefits, profits or advantage."

Clearly, the meaning of "beneficiary" is not limited to a person named in a will or trust or to a person who takes by virtue of intestacy, as the respondent has contended in the Court below. It has the broader and more general meaning shown in the dictionary definition. It has the limited meaning which the respondent and Court below wish to ascribe to it only when used in conjunction with defining language manifesting an intent to so limit and narrow the meaning.

POINT TWO

PETITIONER BORE THE BURDEN OF THE EXPENSES OF THE TRUST

The Court below has also concluded that the taxpayer did not bear the burden of any of the expenses of the trust and is, therefore, not entitled to any of the deductions for that reason. (Appendix at 19)

It has been stipulated as a fact that:

1. The amount potentially available for distribution to the Taxpayer herein was reduced by the sum of $14,394.12. (Appendix at 8, paragraph 21)

2. The said sum of $14,394.12, which was 10.7142 per cent of the $134,346.15 deductible expenses in excess of income for the trust for the year 1968, was the amount claimed as a deduction by the taxpayer (paragraph 19 and 20) and that said 10.7142 per cent was the taxpayer's pro rata share of the fund. (Appendix at 8, paragraph 20)

Despite the foregoing stipulations of fact the Tax Court concluded that the taxpayer did not bear the burden of the loss of the $14,394.12. It reached this remarkable conclusion by rationalizing that the assignment which transferred and conveyed

the assignor's interest in the estate transferred that portion of her interest which would become payable to her in the event that her aunt, Gertrude Stone, should die without issue surviving. Since none of the corpus of the trust would become payable to Mary Isabelle Llewellyn until after the expenses of its administration and liquidation had been paid, said the Court, this Taxpayer did not bear the burden of any of those expenses, even though $14,394.12 was taken out of the amount that the Supreme Court of the State of Illinois had decreed was distributable to him, in payment of his pro rata share of the terminal year expenses of the trust in excess of income.

Does the fact that the Taxpayer anticipated that there would be expenses which would diminish the distribution to him control the question of whether he should receive or be deprived of the benefits of a statute specifically designed to provide such benefits? Apparently the Tax Court applied a different standard for a person who takes by bequest, devise or the laws of descent and distribution, although such a person also anticipates that trust expenses will reduce the gross share which he expected.

Expressing it differently, does the fact that a taxpayer anticipates an expense mean that he has not incurred the expense and not been burdened by its resultant reduction in the net distribution to him? The $14,393.12 diminution in the distribution

to the Taxpayer herein was real and painful and he, and he alone, suffered the burden of being deprived of it.

Clearly, the Taxpayer here was the beneficiary of, that is, the person who had the beneficial interest in and who was entitled to and did in fact receive distribution of a share of the trust fund in its terminal year.

Clearly, the amount directed by the Court to be distributed to the Taxpayer was diminished by the sum of $14,394.12, his conceded pro rata share of the unused excess expenses of the trust in its terminal year, thus directly casting upon him the burden of that expense.

The Court below has followed the decision in the case of Sletteland v. Commissioner of Internal Revenue (43 Tax Court 602) which held that the benefits of Section 642 (h) (2) of the Code were intended to be limited to persons named or referred to in the will or trust instrument. In the discussion of the Sletteland case, which follows, it will be shown that the Court, after properly reducing the claimed deductions from $17,512.00 to $36.73 because the excess was not an expense of the trust and because the taxpayer did not suffer the burden of any loss, then went on to decide that, as to the remaining $36.73 the taxpayer was not a qualified "beneficiary" because he was a purchaser of the interest.

POINT THREE

THE CASE OF SLETTELAND v. COMMISSIONER OF INTERNAL REVENUE DISCUSSED AND DISTINGUISHED

The Sletteland case (43 Tax Court 602) appears to be the only case on the subject. In that case the Court stated (p.605) that in order to acquire entitlement to the benefits of the statute these elements must be established:

(1) The estate or trust must have had an excess of deductions over gross income.

(2) Such excess must be in the terminal year of the estate or trust.

(3) Petitioner must be a beneficiary succeeding to the property of the estate or trust.

The Court in Sletteland then went on to determine that, out of $17,512.00 claimed as a deduction, all except the sum of $36.73 were not expenses of the administration of the estate, thereby reducing the area of the subject statute's application to the sum of $36.73.

The Court in the case at bar is not concerned with any question of whether petitioner's deduction of $14,394.12 was an expense of the estate or trust in its terminal year because that fact has been conceded by the respondent in the Stipulation of Facts.

Thus, there is left for determination here only the question of whether petitioner is a "beneficiary succeeding to the property of the estate or trust."

In Sletteland, the Court, after finding that the bulk of the deductions did not qualify because they were not expenses of the estate and that the petitioner there had not suffered the burden of any loss then decided that, as to the remaining $36.73 Sletteland was not a "beneficiary" because he was a "purchaser". The only supportive reasoning for this conclusion is the Court's reference to the fact that Sletteland was not a person named in the will. This limitation of the Statute's application is not found in the statute, in the Tax Regulation which defines the term "beneficiary" or in the Legislative reports. The Court, therefore, read into the Statute and the Regulations words of limitation not contained therein and arrived at a conclusion which ran contrary to the clear and obvious intent to benefit a distributee who bears the loss of unused deductions. In arriving at this unsupported conclusion the Court in Sletteland effectively removed from consideration what may have been a more burdensome question to probe, namely, whether the remaining $36.73 had in fact been incurred as an expense in the terminal year of the trust or in some other year.

The reasoning employed by the Court below in following the Sletteland decision has already been discussed at length in POINT ONE. In summary, the Court has examined a code section which reads:

> " ******* , then such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary or his delegate, to the beneficiaries succeeding to the property of the estate or trust"

and has translated it to read:

> " ******* , then such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary or his delegate, to the beneficiaries to whom distribution is made by virtue of a bequest, devise or inheritance under State succession laws"

The Court has also decided that the Taxpayer herein, out of whose distributable funds there was taken the sum of $14,394.12, representing his pro rata share of trust expenses in excess of income in the terminal year of the trust, has not really borne the burden of this loss because he expected there

would be trust expenses. But it has failed to explain why a person who takes by bequest, devise or inheritance should be allowed the deduction, although he too expected there would be trust expenses.

It is respectfully submitted that the reasoning of the Court below is improper, unsound and strained and so structured as to read the taxpayer out of a benefit provided for him by statute and for which he clearly qualifies in every respect.

CONCLUSION

The decision of the Tax Court rendered in favor of the Respondent should be reversed and a decision should be renddred in favor the Petitioners.

Respectfully submitted

ALAN NEMSER
Pro Se and on behalf of
Petitioner SELMA W. NEMSER
Office & P.O.Address
32 Court Street
Brooklyn, New York, 11201

A 201 Affidavit of Service by Mail
COURT OF APPEALS
SECOND CIRCUIT

LUTZ APPELLATE PRINTERS, INC.

ALAN NEMSER and SELMA W. NEMSER,

Petitioners-Appellants,

- against -

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

Index No.

Affidavit of Service by Mail

STATE OF NEW YORK, COUNTY OF NEW YORK ss.:

I, Eugene L. St. Louis, being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at 1235 Plane Street, Union, New Jersey 07083. That on the 17th *day of* December *19*76*, deponent served the annexed* brief

upon Gilbert E. Andrews, Chief, Appellate Section *attorney(s) for* Resp-Appellee

in this action, at U.S. Department of Justice Washington, D.C. 20530

the address designated by said attorney(s) for that purpose by depositing 3 *true copies of same, enclosed in a postpaid properly addressed wrapper in a Post Office Official Depository under the exclusive care and custody of the United States Post Office Department, within the State of New York.*

Sworn to before me, this 17th
day of December *19*76

Beth A. Hirsh

BETH A. HIRSH
NOTARY PUBLIC, State of New York
No. 41-4623156
Qualified in Queens County
Commission Expires March 30, 1978

Eugene L. St. Louis

Print name beneath signature
Eugene L. St. Louis